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Dear Dale,

Response to statutory consultation on modifications to the RIIO-2 Transmission, Gas Distribution and Electricity System Operator licence conditions

I am writing to respond to Ofgem's statutory consultation on proposed modifications to the RIIO-2 Gas Distribution licence conditions and associated documents published on 15 December 2021.

Having reviewed the licence conditions and relevant documents / files, significant and positive progress can be seen in addressing the snagging issues and CMA remedies. Where there are any outstanding areas or issues remaining, we have provided detailed comments in the Excel file logs that accompany this letter.

I also have a limited number of key points that I wish to highlight in response to the consultation, which are set out below.

Totex disaggregation

We are encouraged by the work undertaken to date, and the collaborative nature of the engagement between Ofgem and GDNs, in finalising the Totex disaggregation following the CMA Final Determinations. However, there is still further work to be done to finalise the approach to determine disaggregated allowances and allowed unit costs set out in the following licence conditions:

- Special Condition 3.1 Base Network Risk Outputs
- Special Condition 3.10 Tier 1 Mains decommissioned Price Control Deliverable
- Special Condition 3.11 Tier 1 Services Repex Price Control Deliverable
- Special Condition 3.14 Fuel Poor Network Extension Scheme volume driver
- Special Condition 3.15 Domestic Connections volume driver
- Special Condition 3.16 Tier 2A mains and services replacement volume driver

Ofgem has set out a plan to recommence the work to finalise the allowances and allowed unit costs for these licence conditions in February 2022 and has asked GDNs to work collaboratively ahead of this to identify potential solutions to the remaining issues.

Once this work reconvenes, we are eager for it to be undertaken at pace, including undertaking the necessary further Statutory Consultation on these licence conditions, so that these key elements of the RIIO-GD2 framework are finalised as soon as possible.



In addition to the work needed to finalise the disaggregated allowances and allowed unit costs, our review of the licence and associated allowance models have highlighted a small number of remaining errors. These include the need to update the definitions of “Ex-Ante Base Revenue” and “Materiality Threshold” in Special Condition 1.1 as well as the allowances shown in Special Condition 3.26 (Personalising welfare facilities Price Control Deliverable) and Special Condition 3.27 (London Medium Pressure Price Control Deliverable) following the CMA Final Determinations.

Network Asset Risk Metric (NARM) handbook uncertainty

We have concerns over the introduction of new clause 5.4 into the NARM handbook which states that the methodology for determining NARM funding adjustments and penalties will not be consulted on, and therefore not determined, until “ahead of RIIO-2 closeout”.

These are key elements of the NARM framework and it is vital that network companies have transparency of the methodologies and incentive properties they are working to as early as possible – ideally before the price control begins and certainly not after the price control has finished, as was the case in RIIO-1.

We are already almost one year into RIIO-2 and have already planned, and in cases contracted, our work for year two based on our current understanding of the NARM methodology. Therefore, we urge Ofgem to commit to working with network companies to finalise all elements of the NARM methodology by no later than the end of 2022, so that we have a clear understanding of the methodology, and the incentive properties within the methodology, to plan and respond to at least for the last three years of the period.

Clause 5.4 of the NARM handbook also sets out a proposal to develop the requirements for companies end of period submissions ahead of closeout. Again, we would urge that in order to give network companies sufficient opportunity to collect, process and store data in the manner that may be required for close out, these requirements should be determined as early as possible during the price control period. The later they are determined, the less likely that networks will be able to meet the requirements.

Secondly, the data/information that will already be provided within the annual RRP will be enough to undertake RIIO-2 close out. The only exceptions would be the provision of information to support discussions around justified over/under-delivery and clearly identifiable over/under-delivery, however the NARM handbook sets out Ofgem’s expectations in these areas. Therefore, this plan to further develop the closeout reporting requirements should be removed from the NARM handbook.

Net Zero Pre-construction Work and Small Net Zero Projects (NZASP) Re-opener

The proposed changes to the NZASP Governance document, in particular the requirement to consider contributions, represents a significant policy change from final determinations, so we are concerned that this hasn’t been subject to further industry engagement before this statutory consultation.

We understand that the introduction of contributions to NZASP is a “lift and shift” of policy from the innovation framework. However, the NZASP is part of the Net Zero suite of mechanisms including the Net Zero and Re-opener Development Fund use it or lose it allowance and the Net Zero re-opener – where no contributions are required.

The policy and intent of the Net Zero mechanisms at Final Determinations was not as additional innovation mechanisms. Instead, in the case of the GDNs, they were intended to provide agile funding mechanisms to support hydrogen readiness rather than companies including speculative costs for this work in their base plans.

This principle and intent would be broken by introducing contributions for the NZASP so it is not appropriate to copy over innovation policy as the default. If Ofgem has specific concerns that the scope of work progressed through the NZASP could extend to include innovation, or largely innovation-related projects, then they could introduce a mechanism to enable NIA/SIF style contributions. However, the default level of expected contribution should be 0% and should only be greater than zero where it is clearly identified and evidenced that it is an innovation project or project that includes significant elements of innovation.

In an earlier draft of the updated NZASP Governance Document Ofgem stated that the level of contribution could be higher to account for non-network (or societal) benefits. This appeared contradictory to other areas



of RIIO-2 policy, including the Business Plan Incentive (BPI), where networks could be rewarded through Consumer Value Proposition (CVP) mechanism for providing additional societal benefits through network activities. As such, we are supportive of Ofgem's decision to remove this reference from the governance document.

Net Zero Re-opener

We have fundamental concerns about the licence drafting for the Net Zero (larger scale) re-opener which we have previously raised both through the business planning process and more latterly through the licence drafting working groups.

It is more likely that this condition will apply to higher value projects (£100 millions) that may subsequently require more extensive licence changes to establish arrangements between multiple licensees to fully enable all types of Net Zero projects. Ofgem must have absolute confidence they have the powers to make the necessary changes to all licences in order to facilitate this.

We would welcome further discussion with Ofgem to consider various scenarios to provide more confidence that the necessary powers are in place and we believe there is benefit in referring to processes that already exist between the ESO and the ETOs which have previously addressed this type of situation.

Commercial Fleet

Given the ever-increasing options of zero carbon commercial vehicles on the market and the ongoing issues with availability or lead times for some vehicles due to the global semiconductor chip shortage, it is important to ensure that Special Condition 3.13 enables all GDNs to adapt the mix of zero carbon commercial fleet vehicles they procure when replacing their traditional internal combustion engine (ICE) commercial fleet during RIIO-GD2.

We believe that the formulae in Special Condition 3.13 is intended to achieve this and can clearly recognise that it delivers it for some GDNs, however the addition of all vehicle categories for all GDNs in Appendix 2 of this condition would ensure that all GDNs can deviate from baseline volumes / category mix. By making this update it will ensure that GDNs have options to mitigate delays to procuring zero carbon vehicles and in turn mitigate any delays in the delivery of carbon reduction benefits.

It will also ensure that if new vehicles become available in a category with a lower incremental unit cost that can do the job of the vehicles that GDNs envisaged needing to procure at the time of submitting their business plans then these savings could be passed on to customers rather than requiring the GDN to procure the more expensive vehicles. Alternatively, it may enable the GDN to procure extra zero carbon vehicles within their base allowance thus delivering a greater output (both vehicles and carbon reductions).

Next steps

We have welcomed the collaborative approach taken with Ofgem and GDNs through the licence drafting working groups and whilst we acknowledge that there are still some areas to be finalised, we look forward to discussing the next steps for the process with you. In the meantime, if there is anything that you would like to discuss further, please do not hesitate to contact me at stephen.hassall@cadentgas.com.

Yours sincerely

[By email]

Stephen Hassall

Head of Regulatory Operations